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Appeals Officer C:CLE:AP:PRS
Cleveland, Ohio

Chief, Branch 5,
CC:IT&A

FACTS

On [REDACTED] ("Taxpayer") entered into an agreement with various unions concerning establishing a supplemental unemployment benefits trust ("Trust" or "SUB"). The Trust was established on [REDACTED] with an independent third party trustee. Under its agreement with the unions, Taxpayer was required to contribute a total of \$ [REDACTED] to the trust over a period of [REDACTED] years. The obligation to contribute the funds to the trust was not contingent upon future events. In particular, the Taxpayer's obligation to pay into the Trust did not depend on the amount, if any, paid out of the Trust to unemployed workers.

For its [REDACTED] federal income tax return Taxpayer deducted the entire \$ [REDACTED] that it was obligated to pay into the Trust.

ISSUE

Was Taxpayer entitled to accrue a deduction in [REDACTED] under §461 for the entire \$ [REDACTED] that it was obligated to pay into the Trust?

CONCLUSION

Taxpayer was entitled to accrue a deduction in [REDACTED] under §461 for the entire \$ [REDACTED] that it was obligated to pay into the Trust.

LAW AND ANALYSIS

Section 461(a) of the Code provides, in part, that the amount of any deduction shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

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Section 1.461-1(a)(2) of the Income Tax Regulations states that under an accrual method of accounting, an amount is deductible in the year in which "all events" have occurred that establish a taxpayer's liability and fix the amount thereof with reasonable accuracy. See also United States v. Anderson, 269 U.S. 422 (1926). In determining whether a liability has become "fixed" and thus constitutes an expense incurred during the taxable year for federal tax purposes, the Supreme Court has held that "a liability does not accrue so long as it remains contingent." Brown v. Helvering, 291 U.S. 193, 200 (1934). In order to satisfy the "all events" test there must be a fixed right or obligation, the amount of which can be determined with reasonable certainty, and there must be a reasonable expectation that the obligation will be paid. G.C.M. 38536 (October 15, 1980); G.C.M. 38155 (November 7, 1979). This case centers around the appropriate application of the "all events" test to Taxpayer's obligation to make payments to the Trust. In particular, the case concerns whether the Taxpayer's obligation is fixed as opposed to contingent.¹

Section 461(h), enacted in 1984, states that the all events test is not treated as satisfied any earlier than when economic performance occurs with respect to that deductible item. For services provided to a taxpayer, economic performance occurs as the services are rendered. The services provided here are those of taxpayer's employees. Section 461(h) applies to amounts with respect to which a deduction would be allowable after the date of enactment of the section (i.e., July 18, 1984). The agreement with the union was entered into in [REDACTED] -- prior to enactment of section 461(h). Accordingly, section 461(h) does not apply to the case at hand.

If taxpayer's obligation is fixed there is little question that it is entitled to a deduction. Rev. Rul. 56-102, 1956-1 C.B. 90, provides that contributions made by an employer into an independently controlled trust, created solely for furnishing supplemental unemployment benefits to certain employees as part of a collective bargaining agreement, constitute ordinary and necessary expenses that are deductible when paid or incurred.²

¹ The amount of the Taxpayer's obligation under its agreement with the union is apparently readily determinable.

² Section 1.461-1(a)(2) of the regulations provides, in part, that any expenditure that results in the creation of an asset having a useful life that extends substantially beyond the close of the taxable year may not be deductible, or may be deductible only in part, for the taxable year in which incurred. The revenue agent does not raise and we do not address the issue of whether payments to the trust create a separate asset having a

Further, case law allows a deduction to taxpayers who incur an obligation to make payments to a SUB. Inland Steel Co. v. United States, 39 AFTR2d 77-398, 76-2 USTC ¶ 9791 (Ct. Cl. 1976); Lukens Steel v. Commissioner, 52 T.C. 764 (1969) aff'd, 442 F.2d 1131 (3d Cir. 1971); Reynolds Metal Company v. Commissioner, 68 T.C. 943 (1977). In contrast, obligations that are contingent are not accruable. Rev. Rul. 72-34, 1972-1 C.B. 132.

The requirement to fund a SUB trust may be fixed even though the taxpayer does not have to make payments into the trust until sometime in the future. In Reynolds Metal Company the Tax Court stated:

The crucial point is the legal liability to pay someone at some point in time. We cannot say, if the time period for payment were so stretched as to render the ultimate liability a practical nullity, that our conclusion would remain the same. However the record does not so indicate quite such a stretch-out in the instant case. The amounts in issue for 1962 and 1963 were paid into Trust III by 1975. The payout did not occur 'decades hence' and such sums were committed to the trust in the year of accrual.

68 T.C. at 960. That case involved the accrual of a taxpayer's obligation to fund a SUB trust with payments in future years. The amounts of those payments was determined by reference to events occurring in the tax years in controversy. Part of the obligation was paid immediately with the balance due some time in the future depending on the cash needs of the trust. The obligation was not cancellable by the taxpayer in question.

The Tax Court's analysis of Reynolds Metal Company is consistent with the Supreme Court's later holding in United States v. Hughes Properties, Inc., 476 U.S. 593 (1986). In Hughes Properties, Inc. the Supreme Court allowed a Nevada gambling casino to accrue a liability for the amount shown at the end of its tax year as jackpots on its progressive slot machines. State law fixed the liability to pay the jackpots by prohibiting altering the amounts shown on the machines. The fact that

useful life beyond the close of the taxable year. Further, this case does not appear to involve a distortion of income such as that in Mooney Aircraft Inc. v. United States, 420 F.2d 400 (6th Cir. 1970), where the taxpayer's obligation to pay off certain notes was extremely remote.

payment might not occur until some unspecified time in the future was held to be irrelevant.³

Reynolds Metal Company and Hughes Properties, Inc. demonstrate that under the accrual method of accounting the timing of payment is irrelevant as long as the liability is fixed. In the instant case, Taxpayer's obligation is fixed within the meaning of section 1.461-1(a)(2) of the regulations. Taxpayer is obligated to make the payments in fixed amounts at fixed times pursuant to the collective bargaining agreement. At no time, including termination of the Trust, could any of the Trust's assets revert to the Taxpayer. Accordingly, under the facts and circumstances of this case, it appears that Taxpayer may accrue its contractual obligation in [REDACTED] to make payments to the Trust in [REDACTED], [REDACTED], [REDACTED], and [REDACTED].

³ In Hughes Properties, Inc., the Supreme Court allowed the deduction even though the payee was not known at the end of the tax year in question. Accordingly, even if this case were properly viewed as a group liability situation similar to The Washington Post Co. v. United States, 69-1 USTC ¶ 9280 (Ct. Cl. 1969) non-acq. Rev. Rul. 76-345, 1976-2 C.B. 134, the Taxpayer would probably prevail if the case were litigated. For your information, attorneys in Chief Counsel (Field Services) informally indicated that the Service probably would not be successful if this case is litigated. They would not recommend pursuing it.